<table>
<thead>
<tr>
<th>comment on the following by (✓) or (✗)</th>
<th>✓ or (✗)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The financial staff’s task is to obtain and use funds so as to maximize the market share of the firm.</td>
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<tr>
<td>2. Two key limitations of the proprietorship for of business involve potential difficulty is raising needed capital and the presence of unlimited liability for business debts.</td>
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<td>3. An agency problem exists when there is a conflict of interest between shareholders and managers.</td>
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<tr>
<td>4. Liquidity ratios show the relationship of a firm’s current assets to its current liabilities, and thus its ability to measure risk.</td>
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<tr>
<td>5. Debt management ratios reveal the extent to which the firm is financed with debt and its likelihood of defaulting on its debt obligations.</td>
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<td>6. With diversification, it is possible to reduce systematic risk.</td>
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<td>7. The coefficient of variation, calculated as the expected return divided by the standard deviation, is a standardized measure of the risk per unit of expected return.</td>
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<tr>
<td>8. One key result of applying the Capital Asset Pricing Model is that the risk and return of an individual security should be analyzed by how that security affects the risk and return of the portfolio in which it is held.</td>
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<tr>
<td>9. Within the concept of time value of money, while the future value is a compounding process, the present value is a discounting process.</td>
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<td>10. If a bank uses quarterly compounding for savings accounts, the effective annual rate of return will be greater than the nominal rate of return.</td>
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<td>11. A call provision gives bondholders the right to demand or “call for,” repayment of a bond.</td>
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<tr>
<td>12. When a bond is called, the issuer receives a call premium as a compensation for the redemption before maturity.</td>
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<tr>
<td>13. A proxy is a document giving one party the authority to act for another party, typically the power to vote shares of common stock. It can be an important tool relating to control of the firm.</td>
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<tr>
<td>14. The Efficient Market Hypothesis (EMH) holds that stocks are always in equilibrium and that it is impossible for an investor who does not have inside information to consistently “beat the market.”</td>
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<tr>
<td>15. The before-tax component cost of debt, which is lower than the after-tax cost, is used for the purpose of developing the firm’s Weighted Average Cost of Capital (WACC).</td>
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<tr>
<td>16. In capital budgeting and cost of capital analyses, the firm should always consider retained earnings as the first source of capital, since this is a free source of funding to the firm.</td>
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<tr>
<td>17. The cost of new common equity is higher than the cost of retained earnings because the firm must incur flotation expenses to sell stock.</td>
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<tr>
<td>18. It is better to use the discounted payback period method instead of the regular payback period method, as it does not ignore the cash flows beyond the payback period.</td>
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<tr>
<td>19. Mutually exclusive projects are projects whose cash flows are not affected by the acceptance of nonacceptance of the other projects.</td>
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<tr>
<td>20. The crossover rate is the discount rate at which the NPV profiles of two projects cross and thus, at which the project’s NPVs are equal.</td>
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</tr>
</tbody>
</table>
Problem 1:
The following ratios are calculated for Kuwait Company
Return on equity (ROE) = 15%
Return on assets (ROA) = 8%
Profit Margin (PM) = 6%

What is the equity multiplier (EM) and the assets turnover (AT)?

(EM) (AT)
   a. 1.875  1.111
   b. 1.111  1.875
   c. 1.875  1.333
   d. 2.133  3.211
   e. 3.212  2.277

Problem 2:
Given the following facts for Morgan Co, what is the Times-interest-earned ratio?
Debt outstanding = $600,000
Interest rate = 6% annually
Sales = $2,000,000
Tax rate = 40%
Net Profit Margin = 7%

   a. 3.86
   b. 6.38
   c. 7.48
   d. 8.63
   e. 9.23

* The balance sheet:
   a. summarizes the firm’s revenues and expenses over an accounting period.
   b. reports how much of the firm’s earnings were retained in the business rather than paid out in dividends.
   c. reports the impact of a firm’s operating, investing, and financing activities on cash flows over an accounting period.
   d. states the firm’s financial position at a specific point in time.

* Cross-sectional analysis deals with the comparison of one firm to what?
   a. Similar firms
   b. Industry averages
   c. Predetermined benchmarks
   d. Itself over time

* Time series analysis deals with the comparison of one firm to what?
   a. Industry averages
   b. Predetermined benchmarks
   c. Itself over time
   d. Similar firms

* Ultimately, this type of ratio is seen as the most influential, since they represent the financial success of the company.
   a. Debt
   b. Profitability
   c. Liquidity
   d. Market

* The return on equity (ROE) ratio deals with how well management is converting assets into profits.
   True
   False

* Which of the following is not considered a liquidity ratio?
   Current ratio
   Net Working Capital
   Quick ratio
   Total asset turnover

* Financial statement analysis is useful to:
   a. help anticipate future conditions
   b. as a starting point for planning actions that will improve the firm’s future performance
   c. both a and b are true
   d. neither a nor b are true
Debt management ratios:
a. measure the amount of debt the firm uses.
b. measure how effectively a firm is managing its assets.
c. show the relationship of a firm’s cash and other current assets to its current liabilities.
d. show the combined effects of all areas of the firm on operating results.

Other things held constant, which of the following will not affect the quick ratio? (Assume that current assets equal current liabilities and inventory has a positive balance.)
a. fixed assets are sold for cash
b. cash is used to purchase inventories
c. accounts receivable are collected
d. long-term debt is issued to pay off a short-term loan

Which of the following are limitations of the times interest earned ratio?
a. it does not consider interest payments
b. it does not consider fixed financial payments other than interest
c. it uses earnings before interest and taxes which does not represent all of the cash flow available to service debt
d. all of the above are correct
e. b and c are correct

P/E ratios are reflections of:
a. the firm’s growth prospects
b. the firm’s risk
c. both a and b
d. neither a nor b

A modified Du Pont chart shows how return on equity is affected by:
a. profit margin on sales
b. total assets turnover
c. leverage
d. all of the above

When using ratio analysis you are most likely to compare your company’s ratios with:
a. those of companies in other countries.
b. those of companies in different industries.
c. those of companies in similar industries.

Increasing a firm’s return on common equity will definitely increase the stockholders’ wealth.
a. True
b. False

At year-end 1999, Jordan Company’s balance sheet showed current assets = $800, fixed assets = $1,500, intangible assets = $300, current liabilities = $600, and long-term liabilities = $1,400. What is the value of the shareholders’ equity account?
A) $ 300  
B) $ 500  
C) $ 600  
D) $ 900  
E) $1,100

RDJ Manufacturing had 300 million shares of stock outstanding at the end of 2000. During 2000, the company reported net income of $600 million, retained earnings of $900 million, and $240 million in dividends paid. What is RDJ’s earnings per share?
A) $0.50  
B) $0.67  
C) $0.80  
D) $1.25  
E) $2.00

The equity multiplier ratio is measured as:
A) Total equity divided by total assets.
B) Total equity plus total debt.
C) Total assets minus total equity, divided by total assets.
D) Total assets plus total equity, divided by total debt.
E) Total assets divided by total equity.
F)  

The equity multiplier ratio is measured as:
A) Total equity divided by total assets.
B) Total equity plus total debt.
C) Total assets minus total equity, divided by total assets.
D) Total assets plus total equity, divided by total debt.
E) Total assets divided by total equity.

Return on equity will increase if the ________.
A) profit margin decreases
B) return on assets increases
C) debt-equity ratio decreases
D) accounts receivable turnover increases
E) total asset turnover decreases
Which of the following statements is true?

A) The smaller the current ratio the more liquid the firm.
B) Since inventory is not as liquid as the other current assets it is excluded in calculation of the quick ratio.
C) A current ratio of greater than one indicates net working capital is negative.
D) In firms with inventory the quick ratio will always exceed the current ratio.
E) A current ratio can be less than zero.

The RRR Company has a target current ratio of 2.5. Presently, the current ratio is 3.4 based on current assets of $6,902,000. If RRR expands its inventory using short-term liabilities (maturities less than one year), how much additional funding can it obtain before its target current ratio is reached?

a. $1,218,000
b. $730,800
c. $936,886
d. $1,282,554
e. $1,369,397

Last year YYY Company had a 9.00% net profit margin based on $22,000,000 in sales and $15,000,000 of total assets. During the coming year, the president has set a goal of attaining a 14% return on total assets. How much must firm sales equal, other things being the same, for the goal to be achieved?

a. $23,333,333
b. $22,000,000
c. $26,722,967
d. $25,603,667
e. $19,740,600

Other things held constant, which of the following will not affect the current ratio, assuming an initial current ratio greater than 1.0?

a. Fixed assets are sold for cash.
b. Long-term debt is issued to pay off current liabilities.
c. Accounts receivable are collected.
d. Cash is used to pay off accounts payable.
e. A bank loan is obtained, and the proceeds are credited to the firm’s checking account.

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e. A bank loan is obtained, and the proceeds are credited to the firm’s checking account.

All else being equal, which of the following will increase a company’s current ratio?

a. An increase in accounts receivable.
b. An increase in accounts payable.
c. An increase in net fixed assets.
d. Statements a and b are correct.
e. All of the statements above are correct

Which of the following actions will increase a company’s quick ratio?

a. Reduce inventories and use the proceeds to reduce long-term debt.
b. Reduce inventories and use the proceeds to reduce current liabilities.
c. Issue short-term debt and use the proceeds to purchase inventory.
d. Issue long-term debt and use the proceeds to purchase fixed assets.
e. Issue equity and use the proceeds to purchase inventory.

Companies A and B have the same profit margin and debt ratio. However, Company A has a higher return on assets and a higher return on equity than Company B. Which of the following can explain these observed ratios?

a. Company A must have a higher total assets turnover than Company B.
b. Company A must have a higher equity multiplier than Company B.
c. Company A must have a higher current ratio than Company B.
d. Statements b and c are correct.
e. All of the statements above are correct.

Which of the following actions can a firm take to increase its current ratio?

a. Issue short-term debt and use the proceeds to buy back long-term debt with a maturity of more than one year.
b. Reduce the company’s days sales outstanding to the industry average and use the resulting cash savings to purchase plant and equipment.
c. Use cash to purchase additional inventory.
d. Statements a and b are correct.
e. None of the statements above is correct.
As a short-term creditor concerned with a company’s ability to meet its financial obligation to you, which one of the following combinations of ratios would you most likely prefer?

<table>
<thead>
<tr>
<th>Current ratio</th>
<th>TIE ratio</th>
<th>Debt ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. 0.5</td>
<td>0.5</td>
<td>0.33</td>
</tr>
<tr>
<td>b. 1.0</td>
<td>1.0</td>
<td>0.50</td>
</tr>
<tr>
<td>c. 1.5</td>
<td>1.5</td>
<td>0.50</td>
</tr>
<tr>
<td>d. 2.0</td>
<td>1.0</td>
<td>0.67</td>
</tr>
<tr>
<td>e. 2.5</td>
<td>0.5</td>
<td>0.71</td>
</tr>
</tbody>
</table>

You are an analyst following two companies, Company X and Company Y. You have collected the following information:

The two companies have the same total assets.

Company X has a higher total assets turnover than Company Y.

Company X has a higher profit margin than Company Y.

Company Y has a higher inventory turnover ratio than Company X.

Company Y has a higher current ratio than Company X.

Which of the following statements is most correct?

a. Company X must have a higher net income.

b. Company X must have a higher ROE.

c. Company Y must have a higher quick ratio.

d. Statements a and b are correct.

e. Statements a and c are correct.

*Some key financial data and ratios are reported in the table below for Hemmingway Hotels and for its competitor, Fitzgerald Hotels:

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Hemmingway Hotels</th>
<th>Fitzgerald Hotels</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit margin</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>ROA</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>Total assets</td>
<td>$2.0 billion</td>
<td>$1.5 billion</td>
</tr>
<tr>
<td>BEP</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>ROE</td>
<td>18%</td>
<td>24%</td>
</tr>
</tbody>
</table>

On the basis of the information above, which of the following statements is most correct?

a. Hemmingway has a higher total assets turnover than Fitzgerald.

b. Hemmingway has a higher debt ratio than Fitzgerald.

c. Hemmingway has higher net income than Fitzgerald.

d. Statements a and b are correct.

e. All of the statements above are correct.

The Amer Company has the following characteristics:

Sales $1,000
Total assets $1,000
Total debt/Total assets 35%

Basic Earning Power (BEP) ratio 20%
Tax rate 40%
Interest rate on total debt 4.57%

What is Amer’s ROE?

a. 11.04%

b. 12.31%

c. 16.99%

d. 28.31%

e. 30.77%

A firm that has an equity multiplier of 4.0 will have a debt ratio of

a. 4.00

b. 3.00

c. 1.00

d. 0.75

e. 0.25

A firm has total interest charges of $10,000 per year, sales of $1 million, a tax rate of 40 percent, and a net profit margin of 6 percent. What is the firm’s times interest earned ratio?

a. 16

b. 10

c. 7

d. 11

e. 20

د. احمد يوسف دشتي
*The Merriam Company has determined that its return on equity is 15 percent. Management is interested in the various components that went into this calculation. You are given the following information: total debt/total assets = 0.35 and total assets turnover = 2.8. What is the profit margin?

a. 3.48%  
б. 5.42%  
в. 6.96%  
г. 2.45%  
д. 12.82%

*Given the following information, calculate the market price per share of WAM Inc.

- Net income = $200,000
- Earnings per share = $2.00
- Stockholders’ equity = $2,000,000
- Market/Book ratio = 0.20

a. $20.00  
b. $ 8.00  
c. $ 4.00  
d. $ 2.00  
e. $ 1.00

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b. 5.42%  
v. 6.96%  
g. 2.45%  
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- Stockholders’ equity = $2,000,000
- Market/Book ratio = 0.20

a. $20.00  
b. $ 8.00  
c. $ 4.00  
d. $ 2.00  
e. $ 1.00

*Lombardi Trucking Company has the following data:

- Assets: $10,000  
- Profit margin: 3.0%  
- Tax rate: 40%

- Debt ratio: 60.0%  
- Interest rate: 10.0%  
- Total assets turnover: 2.0

What is Lombardi’s TIE ratio?

a. 0.95  
b. 1.75  
c. 2.10  
d. 2.67  
e. 3.45
* Lone Star Plastics has the following data:
  
  Assets: $100,000  Profit margin: 6.0%  Tax rate: 40%
  Debt ratio: 40.0%  Interest rate: 8.0%  Total assets turnover: 3.0

  What is Lone Star's EBIT?
  a. $3,200
  b. $12,000
  c. $18,000
  d. $30,000
  e. $33,200

* Company A has sales of $1,000, assets of $500, a debt ratio of 30 percent, and an ROE of 15 percent. Company B has the same sales, assets, and net income as Company A, but its ROE is 30 percent. What is B's debt ratio? (Hint: Begin by looking at the Du Pont equation.)
  a. 25.0%
  b. 35.0%
  c. 50.0%
  d. 52.5%
  e. 65.0%

* Holding all else equal, ROE will fall with a rise in:
  A. the book value of stockholders' equity.
  B. profit margin.
  C. sales.
  D. leverage.

* A common-size balance sheet shows a firm's assets and liabilities, and shareholders' equity as a percentage of:
  A. total sales.
  B. net income.
  C. total shareholders' equity.
  D. total assets.
  E. total liabilities.

* If a firm's net profit margin declines and the CEO wants to maintain the return on shareholder equity, he must:
  A. increase the firm's utilization of assets.
  B. reduce the amount of debt in the firm's capital structure.
  C. increase the firm's total sales.
  D. increase the firm's total shareholder equity.
  E. increase the firm's average collection period.

* Financial ratios are used by management for ________________.
  A. analysis.
  B. analysis and monitoring.
  C. monitoring and planning.
  D. analysis, monitoring, and planning.

*. The ______ ratio analysis and the ______ analysis in combination provide the financial analyst with a fairly clear picture of a firm's performance.
  A. market-based; profitability
  B. liquidity; asset management
  C. financial leverage management; market-based
  D. liquidity; profitability
  E. comparative financial; trend

*. Please supply the missing figures:

<table>
<thead>
<tr>
<th>(NPM) Net Profit Margin</th>
<th>(TAT) Total Asset Turnover</th>
<th>(ROI) Return on Investment</th>
<th>Equity Multiplier</th>
<th>Return on Stockholders' Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. 20.0%</td>
<td>0.75</td>
<td>__</td>
<td>1.00</td>
<td>____</td>
</tr>
<tr>
<td>b.</td>
<td></td>
<td>8.0%</td>
<td>1.50</td>
<td>__25.0%</td>
</tr>
<tr>
<td>c. 2.5%</td>
<td>4.00</td>
<td>__</td>
<td></td>
<td>__14.4%</td>
</tr>
<tr>
<td>d. 6.0%</td>
<td></td>
<td>9.0%</td>
<td></td>
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</table>